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CHAPTER VI

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FISCAL STRUCTURE IN B-H AND THE PROBLEMS IT GENERATES

1. The Basic Institutional Framework and the Most Significant Problems

The Dayton Peace Agreement established B-H as an independent state with two equal entities. However, the definition of the entities on the basis of nationality (or ethnicity), with FB-H as the entity of the Bosniac and the Croat people, and RS as the entity of the Serb people, created problems of human rights violations from the beginning of implementation. The definition of the entities produced a much stronger position of the entities in relation to the state (joint) institutions of power. Responsibilities in fiscal policy were not mentioned in the B-H Constitution, and the state bodies (Council of Ministers of B-H) were not assigned any roles in the collection of public revenue. This paradox of a state with no competence in control and collection of public revenue had (and continues to have) serious consequences in terms of the ability to maintain macro-economic stability and to establish effective market structures.

The constitutions and laws of the entities, derived from the position assigned to them which bore elements of statehood more than B-H itself, defined the structure of fiscal revenue. As the Constitution of FB-H and the earlier Washington Agreement had already determined the political structure of this entity, pursuant to these documents the cantons were assigned a greater level of responsibility in collection and distribution of fiscal revenue. As the state level had no competencies in controlling and collecting fiscal revenue, the entities passed laws on public revenues, in agreement with IMF, and thus defined customs duties as their own revenue with the entity governments responsible for their collection, distribution and control. ***This paradox, allowing local authorities to control the flow of goods, labor and services, along with a nationalist definition of the entity, bore a direct impact on the creation of room for huge customs and excise fraud, allowing political structures in power and persons linked to them to create an economic basis for strengthening their own position and undermining the sustainability of the B-H economy as a whole.***

Article 8 of the Dayton Peace Agreement gave the entities the right to regulate the fiscal system primarily in accordance with the interests of the respective entity. The only provision establishing a link between the entities and the state authorities is that the entities will finance the budget of B-H with their revenue, two thirds from FB-H and one third from RS (for financing joint institutions and foreign debt repayment, allocated to the entities in accordance with pre-war debt). The only original revenue of the B-H budget are administrative taxes regulated by state bodies. Sources and structure of the B-H budget are presented in the following table.

Table 1. Budget of B-H institutions for 2000

No.	TYPE OF REVENUE/EXPENDITURE	AMOUNT
	R E V E N U E	
1.	Transfer from Federation of B-H	29,700,000
2.	Transfer from Republika Srpska	14,900,000
3.	Administrative taxes	27,646,000
4.	Donations	11,000,000
5.	Foreign debt repayment	
	- Federation of B-H	123,600,000
	- Republika Srpska	74,100,000
	TOTAL REVENUE	280,946,000
	E X P E N D I T U R E	
1.	Current expenditure of B-H institutions	83,246,000
2.	Foreign debt repayment	
	- World Bank - IBRD loan	75,816,978
	- IMF loan	53,929,313
	- Paris Club	31,263,708
	- Other loan liabilities	36,690,001
	TOTAL EXPENDITURE	280,946,000

Source: Official Gazette of B-H, No. 28/00, p.649.

I believe that the biggest oversight of the international community was in allowing the entities to maintain a very strong position in controlling, or rather abusing, the state borders. If we accept the fact that, due to the problems of power structure immediately after the Dayton Peace Agreement, it was not possible to impose a State Border Service, this measure should have been imperatively introduced together with the establishment of the Central Bank of B-H and the introduction of a single currency. This position is further confirmed by the fact that in the currency board system the monetary mass and stability of the domestic currency are totally dependent on market trends, i.e. the balance of current transactions. Hanke, Jonung and Schuler state: "A typical currency board system relies entirely on market forces to determine the amount of notes and coins that the currency board supplies¹." In order to allow the market to regulate adequately the amount of money supplied, and in order to maintain the value of the domestic currency, it must be adequately regulated, i.e. the control of flow of goods, labor and services must be effective in order to avoid market imperfections, huge imbalances and unfair competition.

2. Public Revenue Structure and Collection Responsibilities

2.1. The Structure of Fiscal Federalism in the Federation of B-H

The structure of fiscal federalism in the territory of B-H was established by the Law on Public Revenues in the Federation of B-H and the Financing of the Federation of

¹ See Steve H. Hanke, Lars Jonung, and Kurt Schuler, *Russian Currency and Finance - A currency board approach to reform*, London, New York: Routledge, 1993, p. 63.

Bosnia-Herzegovina² and a later Law on Budgets in the Federation of Bosnia-Herzegovina³. As these laws came into force, an Instruction was also published on public revenue payment accounts for the territory of the Federation of B-H, ways of payment of such revenue, ways and deadlines for its distribution and on users and their reporting⁴. The transfer of the domestic payment system from the Payments Bureau to commercial banks implied a change in the Instruction, as the accounts of the budget and non-budget funds were transferred to commercial banks⁵.

Pursuant to Article 4 of the Law on Public Revenue, the Federation of B-H has the following revenue: from customs paid by natural and legal persons; customs duties, excise (special sales tax), gains tax from banks and other financial institutions, insurance and underwriting companies, legal persons in the field of power supply, postal services and telecommunications, and legal persons with lottery and amusement as their sole business activity⁶; Federation administrative taxes; court taxes from courts of the Federation of B-H; fines collected on Federal regulations; revenue from natural resources; donations and other revenue (from property etc.).

Article 7 of the same law prescribed that cantonal budgets have the following revenue: goods and services sales tax; corporate tax excluding companies and legal persons listed as revenue of the Federation B-H budget; income tax; fines collected on cantonal regulations; donations and other revenue. Cantonal assemblies pass laws prescribing administrative and court taxes on the level of the canton. Municipalities collect revenue as determined by cantonal regulations. According to the budget structure of the Sarajevo Canton, the main sources of public revenue of municipal budgets are transfers from the Canton and revenue collected on the basis of property tax. Municipal budget revenue also includes administrative and court taxes at the municipal level, donations earmarked for this level of authority, fines collected on the basis of municipal regulations and other (auxiliary) public revenue.

Public revenue of the FB-H budget is used for financing the institutions of the legislative, executive and judicial branch on the level of FB-H, organs and institutions established by the Federation, reconstruction within World Bank reconstruction projects, institutes and institutions of particular interest to the Federation in the field of health, education, social welfare, science, culture and sport, penal institutions established by the Federation, funds for assistance to the cantons, state stock reserve and the Army of the Federation. Criteria for the allocation of funds for assistance to cantons are adopted by the Government of the Federation of B-H in accordance with the economic situation of the respective canton. Cantonal budgets finance expenditure required for the legislative, executive and judicial institutions at the level of the canton, health care, education (primary, secondary and higher), culture (other than institutions and facilities of interest to the Federation), social welfare and other needs as determined by cantonal authorities. The most important items in the structure of revenue of the FB-H budget are revenues collected from customs and excise, while the largest expenditure is for the Army of FB-H and social benefits for invalids and families of soldiers killed in the 1992-1995 war.

² Law on Public Revenue in the Federation of Bosnia and Herzegovina and on Financing of the Federation of Bosnia and Herzegovina, Official Gazette of the Federation of B-H, No. 26/96.

³ Law on Budgets in the Federation of Bosnia and Herzegovina, Official Gazette of the Federation of B-H, No. 20/98.

⁴ Instruction on Payment Accounts for Public Revenue in the Territory of the Federation of Bosnia and Herzegovina, Ways of Payment of Public Revenue, Ways and Deadlines for its Distribution and on Users and their Reporting, Official Gazette of the Federation of B-H, No. 27/96.

⁵ Instruction on Payment Accounts of Budget Revenue and Non-Budget Funds in the Territory of the Federation of Bosnia and Herzegovina, Ways of Payment of Budget Revenue, Ways and Deadlines for Distribution to Users and their Reporting for 2001, Official Gazette of the Federation of B-H, No. 55/00.

⁶ Law on Changes and Amendments to the Law on Public Revenue of the Federation of Bosnia and Herzegovina and Financing of the Federation of Bosnia and Herzegovina, Official Gazette of the Federation of B-H, No. 32/98.

Non-budget funds are the Public Fund for Pension and Disability Insurance of B-H, Employment Bureau of FB-H, and other funds as defined by law. Sources of funding for these funds are earmarked benefit payments, the amount of which is determined by the Law on Social Security Benefits⁷. Social security benefits are compulsory, and they are used for financing pension and disability insurance, health insurance and unemployment insurance. Money collected through payment of benefits is non-budget revenue, i.e. revenue of the above funds. Social security benefits are paid on two bases: from personal and other income at the expense of the insurance holder, and from the salaries paid at the expense of the employer. Non-budget funds are obliged to prepare financial plans for the following fiscal year, in accordance with guidelines for preparation of financial plans prescribed by the Government of FB-H. Draft financial plans of non-budget funds are submitted to the minister of finance, and the final approval of financial plans of these institutions is given by the Parliament of FB-H.

The above interpretation of legal provisions is necessary for an understanding of the fiscal capacity of any given level of government and their ability to engage finance for the provision of quality education, minimum social security for the most vulnerable categories of the population, and for promotion of employment through capital investment. That is, as cantons are responsible for financing education (primary, secondary and higher) and social welfare (except for invalids of war and families of soldiers killed in the war), the fiscal capacity of a canton determines its ability to provide quality education and an acceptable level of social welfare, as well as capacity for capital investment. As sales tax is the dominant element of the budget revenue of any canton (over 50%, i.e. 65% excluding health insurance benefits), it is obvious that the buying power of the population bears the most significant impact on the volume of budget revenue and the capacity for capital investment aimed at reducing unemployment. As the increase of buying power by canton depends to a large extent on the presence of international, i.e. foreign, organizations and their staff and local population employed by those organizations (institutions), the greatest buying power is in the cantons with the largest number of foreigners.

A direct consequence of the existing structure of fiscal federalism in FB-H is a significant discrepancy between budget revenue, total population, number of displaced persons and unemployment rate in cantons in FB-H. The absence of a single institution on the level of B-H, or at least FB-H, with sufficient funds to support employment, thus opening development opportunities for cantons with currently low fiscal capacity and large population, especially displaced persons, decreases the possibilities for an accelerated development, especially in light of the fact that the most significant loan provider for small and medium businesses in Bosnia-Herzegovina - USAID, is not present at all in some cantons (the Una-Sana Canton and the Bosnian-Drina Canton).

2.2. Possibilities of Financing Budget Deficit

Although the Law on Budgets in FB-H provides that the budget deficit is to be funded from revenue realized via loans in the country and abroad, in the past few years the FB-H budget deficit was funded via loans from abroad only (international financial institutions). The Law provides that the FB-H debt may be in form of domestic loan (issue of bonds). The final decision on debt and guarantees is passed by the FB-H Parliament. However, even if the Parliament did pass a decision on the issue of FB-H bonds, the Central Bank of B-H may not be the buyer, as the Law on Central Bank of B-H does not allow this institution to finance the entities' budget deficit. Therefore, formally the buyers may be legal and natural persons from B-H and abroad. In reality, if foreign portfolio buyers were to buy considerable amounts of public debt (bonds), this would entail either the increase of tax rates in the coming years in order to collect funds sufficient for payment of

⁷ Official Gazette of RB-H No. 5/95; Official Gazette of FB-H No. 2/96 and Official Gazette of FB-H No. 35/98.

interest against the issued public debt, or a significant increase of fiscal discipline to facilitate regular collection on liabilities.

In the same way, the entity government would have to provide return on investments by domestic investors or buyers of entity bonds. In order to increase the monetary mass, this approach would be acceptable if it were fully supported by the IMF. In that case, the strict application of the currency board principle would have to be relaxed. The main question in the purpose of public debt issuance is the way it is used. If the funds collected via an issuance of public debt were invested productively (investment into the business sector for restructuring and export orientation of enterprises), it could be justified. An additional benefit from the issuance of state or entity bonds supported by IMF would also be support for the development of capital markets and more successful structuring of portfolios for future investors, especially pension and investment funds.

3. The Fiscal Structure of Republika Srpska

Fiscal policy of RS is dictated by the fact that the Dayton Agreement defined this entity as the entity of the Serb people. From this, the political structures drew the conclusion that fiscal centralization was the more effective system of fiscal management, which has not been confirmed in practice. Namely, the total public revenue in RS is considerably lower than the real needs, especially within the context of maintaining a minimum level of social welfare and social well-being of the citizens. The government structure established following the Dayton Peace Agreement is considerably simpler than that in FB-H. There are only two levels of government in RS: entity and municipal. The RS budget collects revenue based on customs, excise tax, sales tax, various benefits and other revenue assigned to the entity level. Disbursements in FB-H and RS are similar in the sense that the largest expenditure is for the army and soldier-disability payment (in FB-H approximately 65%, in RS approximately 45%), while the differences are a consequence of the fact that RS does not have a cantonal level of government, meaning that expenditures for primary, secondary and higher education are part of the RS budget.

In RS, as in FB-H, problems of collecting revenue sufficient to promote economic growth, quality education and minimum social security arise from the structure of the fiscal system. According to the existing fiscal system, the fiscal capacities of both entities depend primarily on consumption tax (customs, excise and sales tax) and the effective buying power determines the potential budget revenue in different regions. On the other hand, effective buying power does not correspond to the size of the population but rather to the concentration of administrative, educational and cultural institutions, and this, which is a fact which is very important for the entire post-war B-H, depends on the concentration of foreigners. Since the concentration of foreigners (foreign organizations, business representation offices, foreign troops) is much greater in the centers, the buying power is logically greater, and thus the revenue collected via sales tax, customs and excise is greater. In RS, the difference is most evident between Banja Luka and other regions, as in FB-H with a significant difference between Sarajevo and other cantons. Banja Luka provided over 50% (1998) of the total public revenue of the RS budget. However, control of collection of revenue in Banja Luka is considerably better compared with the eastern parts of RS. Therefore, the logical solution would be decentralization of the fiscal system in RS in order to stimulate local (regional) authorities to take greater responsibility for collection of funds and allowing those levels at least some of the responsibilities for utilizing the public revenue collected.

In view of vast tax fraud in both entities, particularly in RS⁸, the following view is probably the best illustration of the main reason why fiscal decentralization should be introduced to RS: ***"A large number of public institutions are financed from the RS budget. Because the RS has existed for only a few years, administrators are inadequately trained and prepared, and control of expenditures and quality of***

⁸ Tomaš, Rajko, *Analysis of Grey Economy in Republic of Srpska*, United Nations Development Programme, 1998.

performance of activities is irregular and weak. Those who are financing the activities of these institutions are not able to fully control their work. Decentralization of the fiscal system could have an impact on the quality of services, since financing and performance of activities would be closer to the final users.⁹

4. Problems of Collection of Public Revenue in B-H

The dynamics of collection of revenue in order to meet the growing planned disbursements in the budgets of both entities has not been satisfactory. According to B-H Central Bank data for 1999, the FB-H budget was realized at 84% of the planned amount (801 million BAM vs. 920 million BAM), while despite the growth of the RS budget in comparison with previous years, the revenue in 1999 was not sufficient to preserve social stability (the amount of realized RS budget was 766 million BAM). The problem of the RS budget is reflected in the fact that the source of funding for the majority of public needs (health, education, support to social security funds) is the RS budget, as this entity does not have the cantonal level of government. The problem of collection of public revenue became even more evident in 2000. The FB-H budget deficit in 2000, covered by foreign loan funds, was 63.8 million BAM. The RS budget revenues in the first eleven months of 2000 were lower than the 2000 plan by as much as 516.6 million BAM. Since the RS budget data was not complete (without December) the extent of the problem that the new RS Government was faced with was confirmed by Prime Minister Mladen Ivanić, stating that the RS budget still requires 320 million BAM for the previous year.

In mid-2000, the IMF mission in B-H issued a strong reaction to the on-going dynamics of budget revenue and benefits collection in relation to the overall burden of enterprises with fiscal duties. For that reason, IMF's future approval of loans for B-H is conditioned by an imperative balancing of the budget and increased efforts in more effective collection of taxes, customs duties and benefits. IMF insisted on changes of the current Law on Pension and Disability Insurance, which would adjust pension payments to be in accordance with real revenue based on pension and disability insurance benefit payments. Since the parliaments of both entities failed to vote for these changes, the High Representative of the international community in B-H issued a Decision on the proclamation of the Law on Pension and Disability Insurance. Huge differences in the total amounts of public revenue between FB-H and RS, as well as different fiscal burdens on enterprises, have been and continue to be one of the most serious threats to the sustainability of the B-H economy. Growing budget disbursements and social security payments, along with insufficient strengthening of fiscal discipline increases directly the dependence on foreign sources of finance (loans). However, these analyses of IMF experts merely confirmed that one of the biggest mistakes of the international community was in allowing a fiscal structure whereby the entities have the power to control foreign trade of goods, labor and services.

Differences in tax systems and the participation of budget revenue in total public revenue continue to create problems in harmonization, i.e. provision for the growing needs for financing social welfare and strengthening public service capacities. The problem of an aging population in B-H, which had appeared as a growing trend in the early 1980s, is multiplied by the fact that a large number of refugees of employment age have remained abroad, while the returnees are mainly elderly persons. The problem of providing an adequate income level for the large number of pensioners in B-H (425,000) and invalids of war and families of soldiers killed in war, must be seen within the context of the existing fiscal burden of the business sector and the evasion of the gray market problem. The

⁹ Mladen Ivanić, *Fiscal Decentralizations and the Efficiency of Public Institutions in the Republic of Srpska*, paper published in: *Forum on Fiscal Decentralization in Bosnia and Herzegovina, Conference Proceedings, the FDI-CEE, Sarajevo*, June 1999, p. 101.

information that in January 2001 281,000 pensioners received a pension in FB-H, while out of 412,805 officially employed persons only 267,000 received a salary, demonstrates the unsustainability of the system. The problem is almost identical in RS, and it has been manifested in the said large budget deficit. A comparison of data on total public revenue in the two entities gives a clear illustration of the disproportion:

Table 2. Public revenue in B-H in 1999

- in 000 BAM

DESCRIPTION	FB-H	RS	BOSNIA-HERZEGOVINA
Total budget public revenue¹⁰	1,874,000	703,000	2,577,000
-Entity budget	801,000	617,000	
-Canton budget	924,000	----	
-Municipal budget	149,000	83,000	
Revenue from social security funds	918,000	185,000	1,103,000
Other	86,000	11,000	97,000
TOTAL	2,878,000	899,000	3,777,000

Source: Central Bank of B-H, Bulletin No. 4, p. 71 for FB-H and pp. 71 and 77 for RS.

Total public revenue in FB-H was 3.2 times higher than in RS (the situation was not significantly different in 2000). The difference in public revenue is considerably higher in relation to the difference in population figures and in average salary levels. On the other hand, difference in public revenue is reflected in the difference in GDP, but in a lower percentage. In 1999, the FB-H GDP was 2.9 times higher than in RS. However, as public spending itself bears a direct impact on GDP trends, the level of the correlation of these two values is indeed significant.

Table 3. GDP of Bosnia-Herzegovina

- in million BAM

	ACTIVITY	FB-H		RS		B - H	
		1998	1999	1998	1999	1998	1999
1	Agriculture, hunting, forestry	621.1	700.0	538.1	618.8	1,159.2	1,318.8
2	Processing industry and energy	1,156.7	1,355.7	453.8	495.0	1,610.5	1,850.7
3	Trade	903.9	1,012.3	175.8	225.0	1,079.7	1,237.3
4	Traffic	482.7	540.6	113.9	121.8	596.6	662.4
5	Construction	346.3	423.2	77.8	89.5	424.1	512.7
6	Public services (administration, defense, education,	1,237.2	1,388.0	276.8	315.0	1,514.0	1,703.0

¹⁰ Total budget public revenue in FB-H includes the budget of the Federation of B-H, budgets of the ten cantons and budgets of all the municipalities; data on Republika Srpska budget public revenue is based on information provided by the RS Ministry of Finance and includes items from the central budget.

	health, etc.)						
7	Other sectors	659.5	690.5	200.6	215.0	860.1	905.5
	TOTAL	5,407.4	6,110.3	1,836.8	2,080.1	7,244.2	8,190.4

Sources: Statistics Institute of FB-H, *Bruto domaći proizvod i investicije u FBiH i kantonima za 1998 godinu*, Statistics Bulletin No. 19, pp. 15-16; USAID, BiH Economic Update, February 22, 2000, p. 46; estimates for FB-H for 1990 are based on estimates made by the Federation Statistics Institute, provided in Government of B-H, *Mjere ekonomske politike Federacije Bosne i Hercegovine za 2000. godinu*, p. 106; projection for Republika Srpska for 1999 is by the author.

The explanation of differences in GDP and public revenue clearly lies in the sources of effective buying power, which are not officially recorded, in the differences of total burden based on collective tax rate and benefits, and in greater input of finance through transfers of B-H citizens working abroad to their families in the country. The estimated number of citizens working abroad originally from the territory of FB-H is 120,000, compared with approximately 30,000 from the territory of RS. Also, the number of foreigners working in FB-H is much higher than in RS, and buying power on that basis is much greater. One of the explanations of such a large difference in the level of total public revenue is poorer control of the financial police in RS compared to FB-H. Specifically, since the cantonal budgets in FB-H are primarily dependent on sales tax as the sole revenue of the canton, financial (collection) services are more effective than those in RS. Therefore a decentralization of the fiscal system in RS to the level of several regions could result in an increase of public revenue.

5. Recent Changes in Taxes and Benefits in the Light of Overall Financial Burden of the Cost of Labour

Fiscal burden of the cost of labour in FB-H is higher than in RS, which is one of the reasons for the difference in the total public revenue collected. In early 2000 the salary tax rate was decreased from 15% to 10% in RS. The same measure was applied by the authorities in FB-H in September. The social security benefits rate was also higher in FB-H than in RS. From September 2000 to mid-April 2001, in FB-H the total fiscal burden against net salary was 76.17%, and 51.2% against gross salary. According to recent information, in early 2001 the collective tax and benefits rate against net salary in RS was 68.2%. Comparing the collective tax and benefits rate against salaries and the ratio of total cost of labour versus salary paid in FB-H with countries listed in the Global Competitiveness Report provides the following picture of fiscal burden:

Table 4. Total fiscal burden against salary paid

COUNTRY	TOTAL FISCAL BURDEN IN % AGAINST SALARY PAID
Hong Kong SAR	102.04
Singapore	118.93
Thailand	119.67
Zimbabwe	122.11
Taiwan	127.74
United States of America	157.43
United Kingdom	176.67
Bulgaria	179.29
Poland	180.56

Russia	191.46
B-H - FB-H	204.92
Ukraine	212.12
Czech Republic	225.15
Slovakia	241.11
Germany	269.82
Hungary	340.24

Source: World Economic Forum, The Global Competitiveness Report 1999, Geneva, Switzerland, p. 313.

Seen within the context of the fiscal burden on the cost of labour in other countries, the burden on the cost of labour in B-H is lower in comparison with the Ukraine, the Czech Republic, Slovakia and Hungary. This comparison provides a basis for a claim that fiscal burden is not as high as often stated by uninformed (or insufficiently informed) persons. However, the main problem of the B-H economy lies in the existence of the gray labour market and an uneven application of current laws in the state and private sectors. Considering these facts, the recent change in salary tax rate and contributions for health and unemployment (a cut), voted for by the Parliament of FB-H on April 12, 2001, will decrease the total fiscal burden of labour cost, measured against salary paid in FB-H from the cited 204.92% down to 178.9%. This will undoubtedly influence a further relaxation for enterprises that register their employees. However, the effect of fiscal reform can only be felt if the legislation is applied to all the players.

6. Problems of the Fiscal Sector

The biggest mistake in the fiscal sector in B-H in the recent period was the absence of state institutions responsible for controlling the flow of goods, services, labour and money on the borders of Bosnia-Herzegovina. This basic shortcoming impacted the 'privatisation' of state border crossing and the use of positions of power by local authorities (entity or cantonal) aimed at acquiring economic gain and unfair competition. The seriousness and long-term consequences of this problem are reflected in the fact that in the currency board regime the stability of domestic currency and the mid and long term sustainability of economic development depend directly on the balance of payments. As the exchange of domestic currency allows access to hard currency for financing imports, and the control of state borders and trade of goods and services was held by local authorities, the resulting losses of public revenue and the creation of a huge black market of goods, labour and services undermined the basis of economic sustainability of Bosnia-Herzegovina.

Contrary to the generally accepted view that tax rates in Bosnia-Herzegovina are among the highest in the world and that they act as a de-stimulator, study results presented in the Report on Competitiveness of Bosnia-Herzegovina¹¹ did not confirm this. However, the main problem identified in the managers' survey carried out in B-H for the purpose of this report lies in an evident tendency towards tax fraud and ineffectiveness of administration in the collection of fiscal revenue.

Problems of the fiscal system in Bosnia-Herzegovina are the existing structure of budget revenue sources and the system of fiscal federalism. In the structure of revenue, consumption taxes are the most important source of budget revenue (customs, excise, sales tax), while the participation of direct taxes remains modest. The structure of fiscal

¹¹ MIT Center of the Faculty of Economics of the University of Sarajevo and the Academy of Arts and Sciences of Bosnia-Herzegovina, *Izvjestaj o konkurentnosti Bosne i Hercegovine*, Sarajevo, October 2000.

federalism results in the creation of huge discrepancies in budget resources available for financing public services, particularly the social welfare sector.

7. Recommendations

7.1. As soon as possible, the state border service should assume control over the remaining state border crossings and border regions in the entire territory of Bosnia-Herzegovina.

7.2. Creation of a single economic space, i.e. a customs union in the territory of Southeast Europe, aimed at promoting free movement of goods, services, labour and capital, may be a huge development incentive, provided the institutional preconditions for effective combat against organised crime in this region are met. With that objective in mind, the European Union, the United Nations and USA should provide full technical and financial support for the organisation of unified services specialised in fighting crime.

7.3. The suggestion of George Soros¹² - that the European Union should compensate the loss of customs revenue in countries of Southeast Europe - should be amended regarding the duration of financial support. Namely, Mr. Soros suggested full compensation in the first year, two-thirds compensation in the second, and one-third compensation in the third year. It is my belief that the financial needs for the development of effective institutional structures against organised crime and for effective social protection will require support by the European Union for budgets of countries of Southeast Europe for a period of at least five years, of which the first three should be 100%, and Mr. Soros' proposal should be applied to the fourth and the fifth year, i.e. 67% and 33% respectively.

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¹² George Soros, *Position paper for the Balkans Task Force of the World Economic Forum*

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